Mid-Minnesota Federal Credit Union
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May 14, 2014

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: NCUA Proposed Rule Revisions to Prompt Corrective Action – Risk Based Capital

Dear Mr. Poliquin:

Mid-Minnesota Federal Credit Union (MMFCU) appreciates the opportunity to comment on NCUA's proposed rule for Prompt Corrective Action – Risk Based Capital (RBC). MMFCU, with assets exceeding $255 million, is a full service credit union serving more than 37,000 members in six rural counties in Central Minnesota. Our services include first and second mortgage lending, as well as, business services that includes business lending. MMFCU is a significant service provider in the communities that we serve, including business services.

While MMFCU acknowledges the need for adjustments to the current regulations for credit union capital, including some form of risk-weighted capital, MMFCU believes that the rule as proposed has significant problems, not the least of which is imposing a greater capital requirement than the FDIC has for the financial institutions it supervises. In addition, the proposed implementation timeline, should the rule be adopted as proposed, is not sufficient for any credit union to plan and adjust its balance sheet to insure sufficient capital is maintained to satisfy the new requirements. We also have concerns about the additional authority NCUA is giving itself in being able to impose additional capital requirements on a credit union due solely to regulator perceived risks (an authority that can already be asserted through the current LUA/Cease and Desist process). Due to these significant and basic issues, MMFCU asks that the NCUA Board consider withdrawing the proposed rule; that the NCUA dialogue with credit union representatives (including the major trade groups) to discuss how the rule as proposed can be changed to accomplish the NCUA objectives of keeping credit unions safe and sound while allowing credit unions to continue to develop and serve their members; then reissue the rule for comment again.

As for the rule as proposed, MMFCU offers the following comments:

MMFCU is in support of comments made by the Minnesota Credit Union Network and the c. myers corporation in their letters dated April 15, 2014 and May 8, 2014, respectively, as well as many other commenters.

Impact on MMFCU Capital

Should the proposed RBC rule be implemented today, MMFCU would still be considered "well capitalized", however, our cushion of dollars of capital to maintain that designation would be negatively impacted, as would our strategic plans for future growth, our ability to add incremental income, and our ability to achieve better asset diversification.

Based on our year-end 2013 balance sheet, our Net Worth Ratio was at 11.22% and our estimated Risk Based Capital Ratio would have been 15.72%, keeping MMFCU in the "Well Capitalized" category. However, if we had maximized our member business loans to 12.25% of assets and had a more diverse investment portfolio as we envision going forward, without changing our asset size (just redistributing our assets), our Net Worth Ratio would fall to 11.10% and the estimated Risk Based Capital Ratio would fall to 13.91%. Furthermore, under the proposed RBC rule, MMFCU's capital buffer would decline by $1.4 million and when redistributing our assets as described above, our capital buffer would decline by $2.4 million.

While these declines in MMFCU's Risk Based Capital Ratios would not affect our "Well Capitalized" status, the slight change in the mix of assets illustrates the effects that can happen with marginal additional risk being taken. The implication is that under the proposed RBC rule our capital buffer in dollars is negatively impacted and if we were to manage our balance sheet to minimize the capital impact, it will significantly impede our ability to produce income, build capital dollars, and fully serve the needs of our members.

702.102 – Capital Classifications

MMFCU supports the retaining of the current definitions of "Well Capitalized", "Adequately Capitalized", "Undercapitalized", "Significantly Undercapitalized", and "Critically Undercapitalized". MMFCU does not support the additional conditions/definitions as proposed to the "risk-based capital ratio" due to our disagreement with specific weightings as described later in this letter.

702.103 – Applicability of risk-based capital ratio

NCUA's blanket definition of a credit union being "complex" solely due to its assets reaching $50 million, subjecting them to the proposed risk-based capital requirement, is inappropriate. As history has shown the financial institution industry, a larger asset size does not necessarily equate to more risk to the NCUSIF or the members of a credit union. "Complex" credit unions have more to do with the types of services, loans, and investments a credit union may have rather than the asset size. MMFCU recommends NCUA consider raising the asset threshold to at least $250 million and/or define specific asset classes (or concentrations of specific asset classes) that would make a credit union be considered "complex" and subject to the proposed RBC rule.

702.104 – Risk-based capital ratio measures

MMFCU recommends that the NCUA consider significant changes to this section of the proposed rule. This is the part of the rule where the NCUA has deviated the most from the risk-based capital system imposed by the FDIC for banks. There appears to be no logic for this deviation other than NCUA trying to regulate through capital requirements rather than through the traditional individual examination process. Within the "Summary of the Proposed Rule" NCUA restates nine different risks that credit unions must manage. This list of risks has always existed and changing capital requirements for all credit unions as a means for NCUA to take substantial risk out of the system is totally inappropriate. Contrary to NCUA's implications that by imposing this new capital standard the system and the NCUSIF would be safer is a fallacy. The credit unions that caused significant losses to the NCUSIF in the recent past appeared to be a case of mismanagement of the credit unions that the proposed RBC rule likely would not have prevented. NCUA stated in its summary that its recommendations for higher capital to these credit unions were "unenforceable". If this is the case, the NCUA should address, in a narrow scope, what authority and processes it would need to address these issues on a case-by-case basis instead of penalizing the vast majority of credit unions with more stringent capital requirements.

With regard to the actual calculation of the risk-based capital ratio, MMFCU believes that the NCUSIF deposit should not be deducted from the risk-based capital ratio numerator (equity) calculation. By deducting the NCUSIF deposit, the NCUA in effect is saying that the NCUSIF deposit should be treated as a total loss. While the NCUSIF is also deducted from the total assets, this still has an effect of lowering the risk-weighted capital ratio. MMFCU proposes that the NCUA keep the NCUSIF deposit in both the numerator and the denominator. Our logic here is that the NCUSIF deposit is a real asset and any potential loss on the deposit is minimal given the recent history of the fund.

MMFCU also believes that limiting the ALLL portion of the numerator to 1.25% of risk assets is inappropriate. While, all credit unions subject to risk-based capital ratio requirements should be following GAAP in determining the proper level of the ALLL, overstating of the ALLL still represents reserves that would otherwise be included in retained earnings. Therefore, the whole ALLL balance should be included in the numerator.

With regard to risk weights, MMFCU believes that many of the risk weights are inappropriate for the actual risks posed by most of the assets and that in general the risk weights of the Basel III for small banks should be followed. Having said that, MMFCU offers specific comments on the following asset classes:

Investments - Under the proposed rule, investments have been weighted progressively higher based on weighted average life. In its summary, the NCUA says that the reason for this is to, "... provide a fair measure of the interest rate and liquidity risks associated with longer term investments ...". This seems to be reaching too far in order to be all encompassing. MMFCU suggests that NCUA consider a 20% weighting for all investments and use other methods to instill higher capital if a particular part of the credit union's investment portfolio fails to meet standards under various rate shocks or its liquidity analysis/plan is inadequate.

Residential Mortgages Guaranteed by FHA or VA – NCUA states in its summary that the reason for weighting this category of loan is due to interest rate risk. MMFCU strongly disagrees with this approach as interest rate risk does not materialize unless the loan is sold, and given that the default risk is removed from these loans, MMFCU urges the NCUA to move these loans to zero weighting as indicated in Basel III Small Bank Standards.

Non-Guaranteed Real Estate Loans – MMFCU disagrees with NCUA's attempt to translate concentration risks of these types of loans into a higher capital requirement. The true risk in this loan type is not the portfolio size on its own, rather, it is the quality of the mortgages. For example, if loans are written to conventional GNMA standards, they are much less risky than non-conforming loans that were written during the financial crisis that caused the large losses to the NCUSIF. MMFCU asks the NCUA to reconsider and lower the weighting to no more than 50% for these loan types in order to bring these in line with the Basel III Small Bank Standards.

Loans/Investments to/in CUSOs – The risk weight of investments in, and loans to, CUSOs seems excessive. We recognize that in a few cases credit unions have incurred losses resulting from CUSOs. However, the potential for loss from a CUSO is highly dependent on the activities the CUSO is engaged in. Often, a CUSO is used to gain expertise in member service areas that a credit union cannot acquire in-house. If a credit union were to engage in the same activity within its normal operations, with a proposed lower risk weight, the actual risk to the credit union would be higher. In the case of MMFCU, our wholly owned CUSO, Mid Minnesota Financial Services, LLC, provides insurance agency services to members and poses very little risk to MMFCU, in fact the benefit of the corporate veil reduces risks. MMFCU urges the NCUA to change the risk weighting in the proposed RBC for CUSO loans and investments to no more than 100%.

Mortgage Servicing Assets – MMFCU routinely sells mortgages to FNMA and the FHLB while retaining the servicing rights. This activity, we believe, is a sound management strategy for liquidity and ALM risks, while allowing us to create a revenue source and maintain the relationship with our members. Currently, MMFCU has over $150 million of mortgages being serviced. This servicing activity, in accordance with GAAP, requires MMFCU to recognize the value of the servicing rights as an asset. MMFCU has a third party vendor periodically analyze this asset and the loans being serviced to determine the asset value and the proper amortization of the asset. We believe that the proposed rule to impose a risk weight of 250% on this asset class is inappropriate. The rule implies that this asset is riskier than any delinquent loan, any mortgage loan, or any member business loan. MMFCU recommends that mortgage servicing assets be weighted at no more than 100%.

Member Business Loans – MMFCU is currently restricted by the maximum member business loan limit of 12.25% of assets. However, we support raising this restriction and are therefore concerned by the high risk weights given to this category. MMFCU recognizes that business lending is inherently more risk than consumer lending, however, we believe that the member business loan regulations are sufficient to mitigate this risk and therefore risk weights not to exceed 100% (the Basel III level) is more appropriate and that concentrations of business loans does not of itself pose more risk requiring a graduated risk weighting.

Due Diligence Requirements for Asset-Backed Investments – While MMFCU understands the concerns of the NCUA regarding credit unions making these types of investments without properly understanding them or monitoring them, we are concerned how NCUA field staff will interpret a credit union's ability to "… demonstrate its comprehensive understanding of an asset-backed investment exposure …" that potentially could force a risk weight of 1,250%. We agree with the requirements in the proposed rule that is needed to demonstrate this "comprehensive understanding", however, we remain concerned over examiner interpretation and no specific means noted to dispute any disagreement.

702.105 – Individual minimum capital requirement

MMFCU believes that this section is unnecessary and should be removed entirely. Sound management and planning requires known regulations applied on a consistent basis. As stated earlier in this letter, within the "Summary of the Proposed Rule" NCUA indicated that its recommendations to credit unions perceived to have significant issues and risks to the NCUSIF necessitating higher capital were "unenforceable". If this is truly the case, then the NCUA should be looking at what authority it needs from Congress in order to have a due process for imposing a higher capital requirement, or, it should use its existing ability to issue LUAs/Cease and Desist Orders. While the current proposal outlines as "examples" of what could trigger higher capital standards being imposed, it fails to outline NCUA's internal approval process and the means a credit union would have to appeal such a decision.

Time for Implementation

Should the NCUA adopt this RBC rule, or an amended rule, the 18 month implementation timeframe is not sufficient. It will take significant time for credit unions to adjust and reposition their balance sheets, as well as, to plan and implement new strategic plans that this rule may very well effect. Therefore, MMFCU strongly encourages the NCUA Board to significantly lengthen the implementation period to at least five years. When banks had risk-based capital requirements imposed, they were given 9 years to plan, it seems only reasonable for credit unions to have at least five years to comply (this would place the NCUA rule taking full effect at approximately the same time as the banks).

Conclusion

MMFCU again thanks the NCUA Board for the opportunity to comment on the proposed RBC rule and urges the NCUA Board to repeal the proposal; rethink its components with input from the comment letters; direct dialogue with credit union representatives (including the credit union national trade associations); and then reissue a new proposed RBC rule for comment.

Sincerely,

Charles Albrecht

Charles Albrecht
President/CEO

Copy: MMFCU Board
MMFCU Asset-Liability Committee
MMFCU Supervisory Committee
MMFCU Senior Management
Minnesota Credit Union Network
Credit Union National Association
Senator Amy Klobuchar
Senator Al Franken
Representative Collin Peterson
Representative Rick Nolan